

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: September 19, 2007

IBA Report Number: 07-88

City Council Docket Date: September 24, 2007

Item Number: 200

Item: Response to the SEC Letter of July 23, 2007 and Discussion of Process
Moving Forward

Background

On Monday, July 23, 2007 Stanley Keller, Independent Consultant, and John Hartigan, SEC defense counsel for the City, received a letter from Kelly C. Bowers, SEC Senior Assistant Regional Director, in response to the Independent Consultant's June 7th Initial Report. Mr. Keller provided the letter to the CFO and the City Attorney's Office the same day he received it, and he suggested that it be provided to the Chair of the Audit Committee. The correspondence was not similarly distributed to the Council President, members of the City Council or the IBA on the 23rd. It was provided to the Chair of the Audit Committee at the end of the week and to the City Council and IBA on Monday, July 30th. Timely distribution of important SEC communications is critical to both branches of government, and responsibilities for this should be clarified for the future.

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The letter from the SEC requested that additional information be provided on the steps taken by the City to adopt the following items discussed in Mr. Keller's report:

- Finalizing the **internal audit function** and hiring a **qualified internal auditor**
- Completing the organization of the **Audit Committee** and selecting **citizen advisors** and **professional consultants** to advise them
- Upgrading to a **new financial accounting system**
- Reevaluating the **roles and accountability of the CFO** and the Auditor and Comptroller
- Evaluating the **disclosure process** and consider moving to a **shelf-like disclosure system**

The SEC letter stated: “please advise us as soon as possible as to the steps taken by the City to adopt the above recommendations or other alternative methods designed to achieve the same objectives ... We are also interested in knowing the estimated timeframe for implementing these recommendations.”

Since the letter was addressed to Messrs. Keller and Hartigan, I requested that Mr. Keller clarify whether the response should come from him or directly from the City. Mr. Keller noted that the City should be responding directly “since it is the City’s response to my (Mr. Keller’s) recommendations.” At a special Audit Committee meeting of August 6th, the CFO discussed several points that he suggested be included in a City response. It was noted at this meeting that this item would be scheduled for full Council discussion on September 4th, 2007. In a letter sent on August 7th, the CFO notified the SEC regarding this schedule.

September 4th Review of Draft Response to SEC

This item was docketed and heard on Tuesday, September 4th for the purpose of reviewing the CFO’s draft response to the SEC letter and discussing the process with Mr. Keller. Mr. Keller indicated at this meeting that advising the City on the City’s response was not within his scope of responsibilities as the City’s Independent Consultant, and, in fact, he considered it to be in conflict with that role. He indicated that it was also outside of his role to see that SEC communications, such as the July 23rd letter, were distributed to the City Council. After considerable discussion about the draft letter and process, and in light of Mr. Keller’s remarks, it was determined that John Hartigan, as the other addressee on the SEC letter, should be part of the discussion. The item was continued in order to allow for the participation of Mr. Hartigan.

It is my understanding that Mr. Hartigan subsequently contacted the SEC to secure additional time for the City to respond; and also advised the CFO that the SEC response should be expanded to incorporate more information.

IBA Comments on Original Draft Letter

At the meeting of September 4th, the IBA suggested a number of additions to Mr. Goldstone’s original draft letter. As of this writing we have not seen a redraft of that letter and are not aware if our suggestions have been incorporated. We, therefore, offer the following additions:

- Incorporate announcement of **appointment of a new City Auditor** if accomplished by letter deadline. Interviews were completed several weeks ago and an announcement is expected within this timeframe.

- Discuss the results of the recent Request for Proposals process to obtain a **professional audit consultant for the Audit Committee**; and the pending recommendation to contract with the firm of **Jefferson Wells** to serve in this capacity. The Audit Committee will consider this action at their meeting on Monday, September 24th.
- Discuss **the new process developed for legislative review of the City's Comprehensive Annual Financial Reports (CAFR's)** that has been put into place by the Audit Committee in conjunction with the Mayor's Office, the City Attorney, the IBA and Mr. Keller, as well as the corresponding **systematic City Council financial training** that has been implemented regarding disclosure and debt issuance.
- Discuss the official formation of the **Ad Hoc Advisory Committee to the Audit Committee** and provide bios of Advisory Committee members. At their first meeting on Monday, September 17th, the Committee appointed William A. Woolson, Ph.D., a leading member of the business community as Chair, and discussed their scope of work beginning with a review of the Audit Committee's process for reviewing the City's CAFR's.
- Discuss the work of the **Charter Review Committee** relative to proposed changes to the Charter to implement **a permanent, independent Audit Committee; increased independence of the Internal Auditor; and establishment of a permanent independent Internal Audit function**, separate from the City Controller, within the City's Charter. The Committee will be acting on their final recommendations relative to these items on Friday, September 21st.

Finally, the IBA strongly recommends that **a single letter to the SEC be authored and signed by both the Mayor and City Council** as representation of the City's ongoing coordination on action steps and commitment to addressing these important matters. The City Council, together with the Mayor and the City Attorney, have worked diligently on a wide-range of remediations and this can best be conveyed in a joint letter to the SEC.

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In his "Initial Report of Independent Consultant to the City of San Diego" (June 7, 2007), Mr. Keller concluded with the following:

"Much more must be done and it remains to be seen whether the City will be successful in implementing the actions already taken and completing the significant remediation still necessary. That success will depend upon . . . the several groups within the City

government operating together to create a culture of compliance rather than one of convenience and disharmony that prevents moving the city forward”

Need for Clarification of Process Moving Forward

During our participation over the last several weeks to achieve a coordinated and timely response to the SEC letter of July 23, 2007, we have noted the following issues regarding interaction with the SEC that could benefit from clarification:

- How do we ensure for the future that all parties-the Mayor, City Council and City Attorney - receive important communications from the SEC in a timely manner and are jointly involved in determining the appropriate response?
- The SEC letter of July 23rd was sent to Messrs. Keller and Hartigan. Does the City need to request that the SEC communicate directly and timely on all such correspondence with the Mayor, City Council President and City Attorney?
- Whose responsibility is it to provide guidance and advice to the Mayor and City Council on interacting with the SEC? Mr. Keller has indicated that this role is in conflict with his duties as Independent Consultant.
- As the City’s SEC defense counsel and the second addressee on the SEC letter, what is Mr. Hartigan’s role in advising the City on interacting with the SEC and are there potential additional contractual costs associated with this?

We raise these issues for further Council discussion.

Summary of Recommendations

The IBA recommends the following:

1. Suggested additions be incorporated into the CFO’s draft letter if not yet reflected.
2. A single letter to the SEC be authored and signed by both the Mayor and City Council.
3. Roles, responsibilities, processes and contracts be clarified regarding interaction with the SEC on a going forward basis.

[SIGNED]

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